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Crises and Stabilizations in Portugal in the twentieth and twenty-first centuries; DR Development and Trade: Topic: The competitiveness of the Portuguese economy in the twentieth and twenty-first centuries

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2. Abstract

The IMF interventions in Portugal lay behind a negative economic context. In this paper, we will explain the negative paradigm that led to the IMF interventions in 1977 and 1983, as well as the success of those programs. We will demonstrate that the negative international context combined with a myriad of negative internal forces created enormous pressure on the balance of payments, a situation that became unsustainable and very difficult to solve without external help. Moreover, we will establish that both programs were successful in solving this disequilibrium while understanding which variables contributed the most to the desired outcome.

4 Keywords:

External context

Internal forces

Balance of payments

Program's success

3.Main Text

Introduction

The IMF was established in 1944 with the purpose of “building a framework for economic cooperation to avoid a repetition of the competitive devaluations that had contributed to the Great Depression of the 1930s” (IMF, 2019). Since its foundation, it has helped member countries to overcome economic difficulties, one of which was Portugal. The organization intervened in the country in 1977, 1983 and more recently in 2010. In this paper, we will focus more on the first two interventions and use the last intervention as a means of comparison.

To understand the effectiveness and success of the programs in Portugal it is of paramount importance to comprehend the context that led to the intervention of the IMF in the first place and how the programs were designed to solve the country’s economic problems.

Context to the IMF intervention

The period that precedes the first IMF intervention in Portugal is characterized by international downfalls. After the golden age of economic growth (1950-1973), most of the European economies entered a period of much poorer performance and Portugal was no exception (Amaral, 2019).

The reasons behind it are both external and internal. Although it is safe to say that external conditions affected all European economies in a similar way, Portugal had some internal forces that aggravated our economic situation. In the Golden age of growth (1950-1973) Portugal was able to converge with the most developed economies, despite the fact that most European countries revealed high GDP growth rates. This contrasts with the following period (1973-1985) where Portugal struggled to keep up with smaller growth rates from most European economies.

Table 1: GDP per capita of several European countries from 1950 to 1985 (average annual growth rates)

	1950-1973	1974-1985
Portugal	5,38	1,60
Austria	4,97	2,32
Belgium	3,56	1,77
Denmark	3,11	1,98
Finland	4,29	2,30
France	4,02	1,77
Germany	5,05	1,99
Greece	6,26	1,68
Ireland	3,06	2,59
Italy	4,97	2,40
Netherlands	3,48	1,32
Spain	5,66	2,02
Sweden	3,23	1,15
Switzerland	3,10	0,69
UK	2,43	1,75

Source: The Conference Board, except Portugal: Amaral (2009)

The Portuguese economy was affected by a set of forces much beyond the control of Portuguese economic or political agents. One of the international shocks occurred in 1973, when the conflict between Israel and the Arab countries led the OAPEC (Organization of Arab Petroleum Exporting Countries) to create an embargo to Israel's most important allies, the United States and the Netherlands and, at the same time, the OPEC (Organization of Petroleum Exporting Countries) raised oil prices. The increase of oil prices had negative impacts on most countries' balance of payments and in the volatility in the markets as little alternatives for this energy existed and Portugal was no exception. According to the Energy Supply Security, around 75% of Portugal's energy came from oil, in 1973. As a consequence of high oil prices, companies increased their costs and were forced to increase prices and lay off workers. As the IMF points out, net imports of petroleum and petroleum products rose from 150 million U.S dollars in 1973 to 540 million U.S dollars the following year, equivalent to two thirds of the deficit in the current account, and rising to 770 Million U.S dollars in 1977. In a world of recession, there

was little room to improve exports. The Portuguese export markets decelerated to a growth of only 11% in the period from 1974 to 1977.

The second international shock that affected most western developed economies was the fall of the Bretton Woods agreements. As the IMF points out, “A sizable increase in domestic spending on President Lyndon Johnson's Great Society programs and a rise in military spending caused by the Vietnam War gradually worsened the overvaluation of the dollar.” It became impossible to convert dollars into gold and consequently, in 1971, the system was suspended. The Bretton Woods Agreements which were highly responsible for the world's economic growth during the period 1950-1971 by originating the increase in trade and capital movements and also by providing stability in prices, ceased to exist.

Furthermore, during the 1950-1971 one other reason for global economic growth was the structural changes in the economy by a gradual shift of capital and workforce from the primary sector to the tertiary sector, being the latter a lot more productive. In the 1970s this transformation became more difficult to continue, as the primary sector already had little workforce and capital. The gains obtained during the 1950-1971 due to commerce also stagnated during the 70s as the liberalization of commerce between industrialized countries was diffused. Lastly, it can be pointed out that the deceleration of the rhythm of growth of the technical progress of industrialized countries, mostly the United States.

The negative international context affected most economies. However, Portugal went through major internal changes that worsened the situation, in particular, through a period of political instability, by changing from a dictatorship to a democracy. It originated several political crises, as the governments that followed did not last long. The political paradigm changed completely as union liberty was allowed and it had great influence in wages and prices in the economy. As such, unions created enormous pressure to increase salaries. Wages increased 7% and 14% in

real terms in 1974 and 1975, respectively, well above productivity (Mateus, 2013). Moreover, with the arrival of the mass of colonists from Africa, the active population grew by about 400,000 people between 1973 and 1975. This tremendous increase in labor force should have led wages down, however, the exact opposite happened, due to the political environment of the country (Amaral, 2019)

Table 2: Real Salaries in Portugal (1973=100)

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
100	113,8	125,5	125,9	115,9	110	102,8	109,6	111,1	107,2	100,6	91,8	92,7

Source: INE

The revolution introduced a myriad of changes in the workplace, being much more favorable to workers. These were granted a lot of privileges such as the right to strike, generalizing for all workers additional remunerations such as the thirteenth month and holiday subsidies, unemployment benefits, unionization became free, a national minimum wage was introduced, reduction in the number of hours of work per week and social and national welfare was increased. Additional legislation was passed to make individual and collective firing very difficult, as the firing of workers became possible only under the principle of “just cause”, which was extremely difficult to prove (Amaral, 2019).

The original revolutionary process was intended to propose new moderate changes to the country, the truth is that it deviated to more extreme Marxist ideals. As a consequence, many sectors were nationalized such as banks and insurance companies (around 1300 companies), sectors considered basic to the economy and the assets of large economic groups.

The different ideals were completely opposite to the ones of the “Estado Novo”. Portugal’s accentuated growth during 1950-1970 which was the period of the most rapid economic growth in Portugal’s history and a period of economic convergence with the most developed economies

in the world. This spectacular economic growth came from low salaries that allowed our industry to grow as well as a gradual replacement of the workforce for equipment, the last being more productive. Moreover, the Portuguese economy was influenced by a very positive international context of growth and economic development. This context was responsible for increases in trade and the development of tourism as one of the country's most important sectors.

The “Estado Novo” besides being a very authoritarian regime, characterized itself by being very interventionist in the economy, despite the fact that the regime had little initiative when it came to creating public companies. The interventionist role of the “Estado Novo” was felt in price controls, tight control of interest rates, exchange rates and other economic mechanisms such as fiscal incentives, tariff exemption ad hoc or the access to credit in benefit for certain activities (Amaral, 2019)

In terms of the discipline of the public accounts, there were also big differences between the “Estado Novo” and the democratic regimes that followed. The first was concerned with maintaining the sustainability of the public accounts, avoiding constant and chronic deficits and keeping revenue and expenses at lower levels, especially when compared with most developed economies at the time.

The “Estado Novo” also made an effort to keep inflation at low levels, with annual rates between 2% and 3%, except in the end of the regime, where inflation rose up to 20%. During the 60s, with an increase in emigration and tourism, the balance of payments improved significantly. Between the 50s and the 60s it is estimated that 1 million people left the country. This movement was very important to increase productivity, as this workforce was underemployed, and it increased emigrant remittances, reaching 8% of the GDP (Lopes, 1996).

In terms of labor policies, the situation was less favorable to workers. Unionization was not free, union negotiation power was limited, strikes were prohibited, workers were expected to

work for long hours and had little privileges, such as short holidays and were not granted minimum salary or unemployment benefits.

Since 1975, the independence of the Portuguese colonies, which played a major role in the development of Portugal's economy in the past, seized to play it. In 1960, 25,9% of Portugal's exports and 14,4% of the country's imports came from the colonies in contrast with only 3,9% and 1,2%, in 1985 respectively. The return of about 600.000 to 700.000 returnees in a short period of time generated many problems, as the country was not prepared for an increase of the population overnight. It generated an increase in the unemployment rate as most of this population was economically active, deteriorated the balance of payments and generated an increase in social expenses. As J. Lopes da Silva refers "This sudden increase in population by about 7 % in the course of one year created serious difficulties for the balance of payments, for the budget and for the unemployment situation, because of the additional needs of food imports, of budgetary support and of jobs for the returnees."

One other shock to the labor market in the same period was the slowing down of emigration, which was responsible in the past for an increase in emigrants' remittances, key to improve the balance of payments. The reason behind it is the fact that European economies were also dealing with the effects of the international crisis, making it more difficult for the active Portuguese workforce to emigrate.

Table 3: Commerce between Portugal and ex-colonies in the Portuguese foreign commerce (%)

	1960	1973	1985
Imports	14,4	10,1	1,2
Exports	25,9	14,8	3,9

Source: Lopes, J.S. (1996) "A economia portuguesa desde 1969", Gradiva, Lisboa

It can be stated that Portugal had two different types of government philosophies, the first being more influenced by socialist and Marxism principles that ruled the country from 1974 to 1976, and a second phase, that was more moderate and ruled the country from 1976 onwards. From 1974 to 1976, governments favored more radical measures and a lot of excesses were made at the time. Many measures were implemented to boost the domestic demand. These measures were successful in increasing it but created undesirable problems, such as a deficit in the public accounts that, according to the Bank of Portugal, rose to 7% (in GDP) in both 1976 and 1977. Price formation continued to be determined by the government. With exploding costs, frozen prices and an overvalued exchange rate (as governments were reluctant to depreciate the currency), firms struggled. Pressure started thus growing for many companies to be taken away from their owners and be nationalized. As such, during an eight month period that started on 11th March 1975, we witnessed one of the biggest nationalization programs in modern European history, especially large and in considered strategic sectors (Amaral, 2018d, and Valério, 2004). The Portuguese entrepreneurial state-owned sector became one of the largest in the Western world, responsible for about 20% to 25% of GDP, 30% of investment and 8% of the workforce (Baklanoff, 1996).

Table 4: Public sector accounts in Portugal (in % of GDP)

	1973	1974	1975	1976	1977	1978	1979	1980
Balance	1,4	-1,6	-5,5	-7	-6,9	-8,4	-8,1	-9,1

Source: Bank of Portugal

There were other movements such as the occupation of factories by workers that affected the property structure of the economy. All this instability made tourism, which was one of the most important sectors in the period of the “Estado Novo”, decline, as Portugal was seen as a risky destination.

Capital flight started, and unemployment rose, which was almost inexistent in 1973 (1,7%), increased to 6,2% in 1974 (Amaral, 2018a and 2018b, and Franco, 1994).

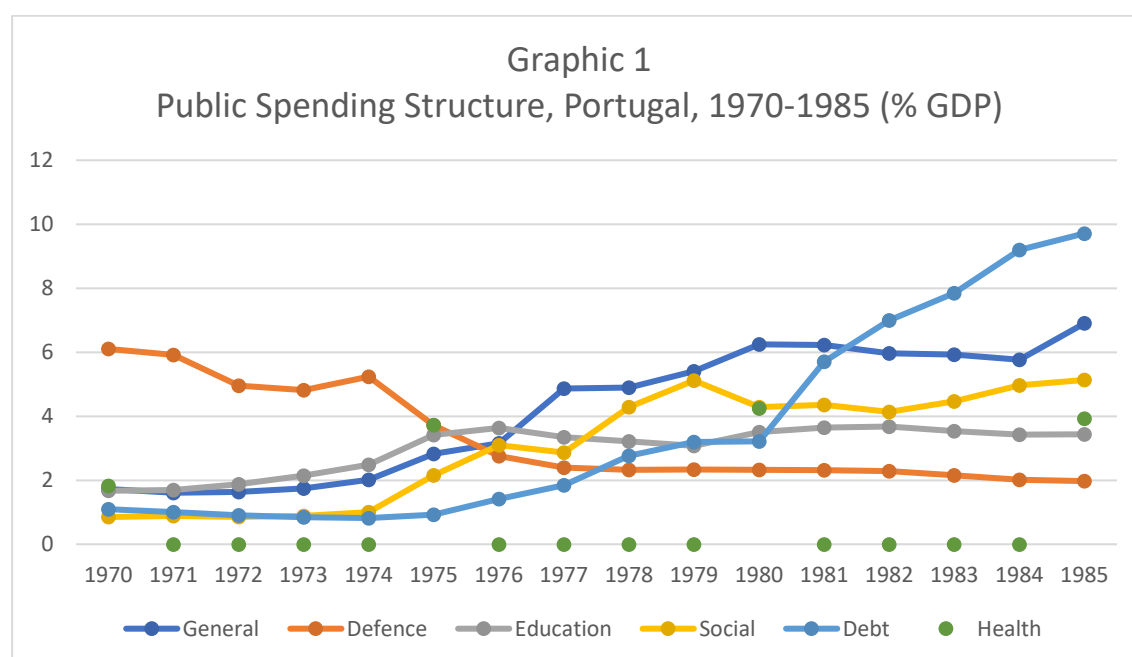
This situation generated a distrust by banks because the public debt began to be unsustainable. As such, foreign investors started to demand more conditions in order to obtain loans.

After 1976, the political process continued to struggle, as the first constitutional parliaments and governments proved to be fragile and unstable. However, the final result was a reversion of the most radical aspects of the revolutionary process, creating a friendlier environment for private capital. The governments changed and overturned some of the most rigid legislation that strongly favored workers and harmed firms. In particular, firing workers became more difficult (Amaral, 2019).

The governments from 1976 onwards had the objectives of fighting the economic difficulties from the two previous years as well as providing the population with social services that most of the European democracies had been developing since the end of the World War II. As such, the government increasing the size of the government (measured by public spending as a percentage of GDP) to levels that were closer to other European countries. The governments increased spending in Education, Health and Social Security and reduced spending on defense, following the trend that most developed countries had adopted since the end of the World War II.

Contrary to the “Estado Novo”, the revolutionary governments were not able to keep a strict policy of budget balance, originating high budget deficits. The reasons behind it do not just lay on increasing spending, but also in the ineffectiveness of the government to increase its revenue. In fact, the tax structure remained largely unaltered in relation to the “Estado Novo”, with only a high increase in progressivity over personal income, in which the government struggled to fight tax evasion (Amaral, 2019). With a continuous increase in spending that is not

compensated with a similar increase in revenue, constant deficits in the public accounts of the new governments were inevitable.



Source: Mata (2001), except Health: Carreira (1995)

Note 1: General = General administrative expenditure; Defence = Military expenditure; Education = Expenditure on Education; Social = Expenditure on Health, unemployment benefits and Social Security; Debt = Debt service; Health = Expenditure on Health

Note 2: As spending gathered in the Social item includes Health, there is a certain duplication with the item Health; also, the figures are not exactly compatible; still they allow to establish a certain order of grandeur

The new governments created more favorable conditions for the economy by using the previous nationalized banking system and practicing negative real interest rates that gave a strong push to investment (Franco, 1994, and Lopes, 1996). This boost in investment was also due to private companies. New mega-projects were initiated, such as the installation of a new petrochemical plant in Sines, the expansion of the only steel plant in the country, building a new chemical plant and the reactivation of some mines (Lopes, 1996). However, contrary to the “Estado Novo”, governments disregarded the price stability. The link between the Bank of Portugal’s gold and currency reserves and money supply disappeared and was replaced by discretionary principles: the Bank of Portugal acquired a series of new instruments to intervene in the money market, namely setting the interest rates practiced by banks and the level of their cash reserves.

The Bank of Portugal also started to become concerned with the issue of short-run economic growth, besides being called on to use money supply in order to finance the growing budget deficits. The inevitable consequence of this set of forces was an acceleration of inflation (Amaral, 2019)

The internal forces aggravated the economic situation of the country, and as such, Portugal went through economic growth between 1973 and 1985 that was much slower than most of the world's developed economies (Table 1). Our situation was also worse than countries such as Spain and Greece that had a similar level of GDP per capita and that also went through a political transition process from an authoritarianism government to a democracy. While Portugal diverged from the world's most developed economies from 1974 to 1976, both Spain and Greece continued to catch up (Amaral, 2019). This particular comparison enhances the consequences of the 1974 revolution and the economic and political context that followed.

As a consequence of a worse context both national and international, most of Portugal's metric variables deteriorated in this period. Inflation rose at a very slow rate in the period of 1960-1970, growing at a higher rate during the years of 1970-1973 and exponentially growing from the years 1971 to 1977. The balance of payments deteriorated significantly. In contrast with the surplus observed in the 60s, the balance of payments deteriorated until 1977 to -8,9% of the GDP (Bank of Portugal). Moreover, our external debt increased significantly, growing from 31,7% of the GDP in 1978 to 74,5% in 1985, due to a significant increase in the Portuguese debt, as the GDP continued to grow at a slow rate. Finally, by analyzing the GDP per capita, it can be pointed out that the Portuguese economy went through a period of growth from 1965 to 1972 followed by a period of deceleration and even a decrease of the GDP per capita in 1975 and 1976 that was caused not only by the increase in population but also by a decrease in the GDP.

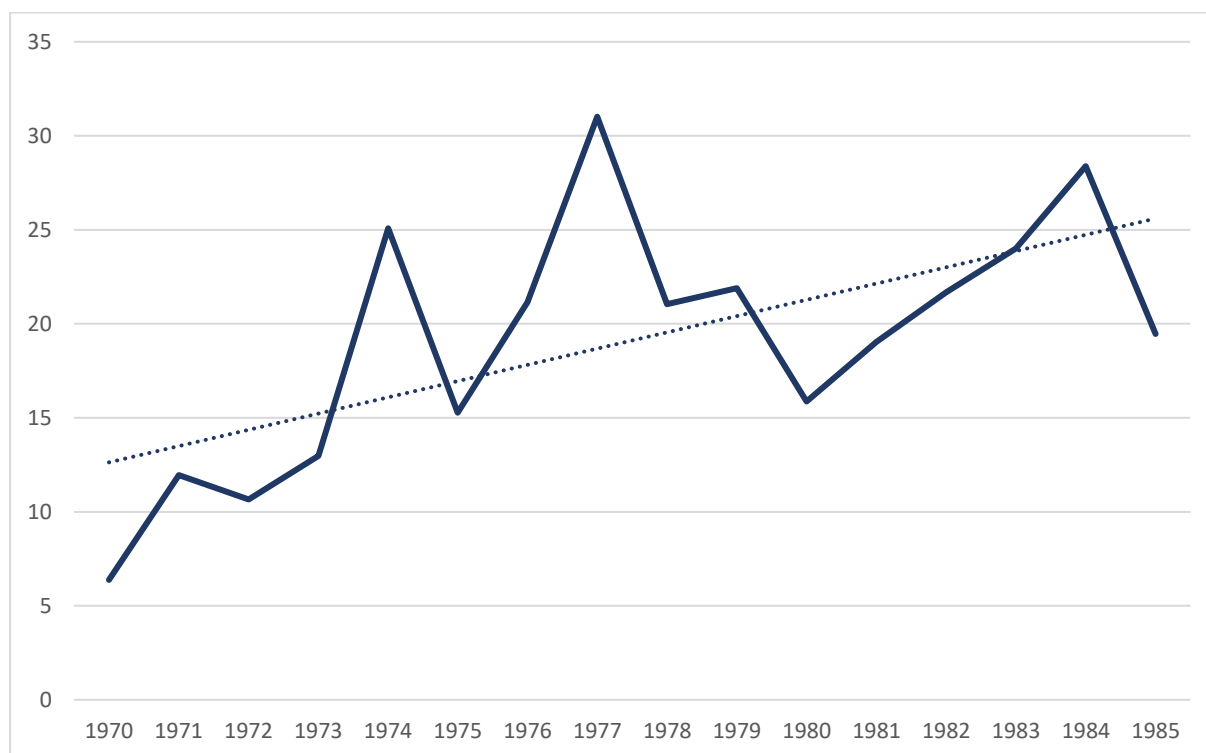
Table 5: Annual growth of the GDP per capita in Portugal

	1965-1972	1973	1974	1975	1976	1977-1982	1983	1984	1985
	(a)					(a)			
GDP per capita	7,11	4,67	0,24	-9,18	-0,24	4,62	0,61	-1,45	1,49

(a) = Average

Source: Amaral, “New Series...”

Graphic 2: Inflation in Portugal from 1970 to 1985



Source: World Bank

Table 6: Balance of payments of Portugal (% of GDP)

	1973	1974	1975	1976	1977	1978	1979	1980
Balance	2,7	-4,6	-6	-7,2	-8,9	1,2	6,7	3,5

Source: Bank of Portugal

The combination of all these factors created enormous pressure on the balance of payments. At first, the governments used the large amounts of reserves in foreign currency and the gold in the Bank of Portugal that was accumulated by the former regime (Lopes, 1996). Later these reserves were depleted and the difficulties in payments got more serious in 1976 and 1977. For a while it was possible to obtain various loans from Western countries and institutions, bent on helping Portugal to remain within the “capitalist” side of the Cold War, such as EEC, EFTA, BIS, or Germany, Switzerland and the US (Lopes, 1996). But as the different steps taken by successive weak governments were not enough to change the situation, a moment came when a more drastic measure had to be used and, as such, Portugal asked for financial help from the IMF.

Despite the expansionist measures used by some Portuguese governments, according to J. Silva Lopes, the deterioration of the balance of payments in 1976 and 1977 occurred mostly because of the “(...) failure to recover the competitiveness lost both in the domestic and in external markets, and to attract a larger proportion of the emigrants ‘savings’”.

IMF program’s objectives

The first request for financial help came in a letter by Portugal’s financial minister at the time, Medina Carreira and by the governor of the Bank of Portugal, Silva Lopes. Portugal asked for an amount of 42,4 million dollars and promised to implement a wide range of economic and political measures to reverse the situation and was obliged to inform the IMF about the progresses made during the program.

The main objective of the program was to reduce the balance of payments deficit from 1,5 billion dollars in 1977 to 1 billion dollars in March 1979 (IMF Report).

IMF Program's Measures

The first and most important measure of the program consisted in depreciating the effective exchange rate of the escudo in order to correct the balance of payments deficit by encouraging exports and diminishing imports. In 1977, the escudo was depreciated in 15% in relation to an average of reference currencies. In August of the same year, a new exchange rate policy was introduced: after one more ad hoc depreciation of 4%, the monetary authorities decided the escudo should depreciate 1% per month, a policy that received the name of crawling peg (Lopes, 1996). This was accompanied by an increase in the Bank of Portugal's discount rate to 6%, in August 1977, in order to avoid the most negative effects of depreciation in terms of capital flight and speculation against the currency (Mateus, 2013). Protectionism was aggravated, through the introduction of quantitative restrictions on various imported goods, adding to the new tariffs coming from 1975. Legislation was passed to limit wage increases to 15% in order to restrain private consumption and sales and petroleum taxes were raised to increase the government's revenue (Amaral, 2019). This effort was intended to slow down the deficit from 5,3% of GDP in 1976 to 4,15 of GDP in the following year (Mateus, 1998). The adoption of the crawling peg required the adjustment of the interest rate policy, in order to avoid speculative capital movements like those which had taken place in 1976 (J. Lopes da Silva, 1983).

The IMF introduced more measures to eliminate 30% of import sub charge that had been introduced in 1975. This measure was controversial, as Portugal had a significant deficit in the balance of payments in recent years and the measure was seen as contradictory. However, it was the IMF's view that an exchange rate devaluation and domestic demand contraction was a much more effective measure to improve the balance of payments rather than import controls.

As J. Silva Lopes points out, “given the small size of the Portuguese economy (...) If the restrictions were concentrated only on those imports which could be easily replaced by domestic production, the savings of foreign currency would fall far behind the amounts needed to reduce the balance of payments disequilibrium to a sustainable level. Moreover, since in the preceding years exports had fallen much more than sales in the domestic market, there was much more idle capacity in the export sector than in import-competing industries. The introduction of tighter import controls would therefore tend to be quickly reflected in higher prices rather than in higher output or employment. Such controls would in no way contribute to easing the crisis of export industries, whose production, in a country with the characteristics of Portugal, can only to a very small extent be shifted to the domestic market. On the contrary, they would reinforce the bias against exports”. Lastly, it is important to point out that import control’s measures would not be well received to Portugal’s main commerce partners and to the EFTA and EEC, as they could retaliate such measures. Expensive export subsidies would probably be needed to put in practice to compensate possible external retaliations.

The IMF program also introduced some very important rise of interest rates for six-month deposits from 11% to 15% in 1977. The effects of this policy in the balance of payments were immediate and powerful. It was an important measure in the capital account as it eliminated a large part of the benefits expected from speculative capital outflows and by making foreign borrowing more attractive and in the current account, as part of the capital movements were in fact affecting the current account through the under-invoicing of exports, the over-invoicing of imports, the black market for tourist receipts and emigrants remittances and the accumulation of stocks of imported goods (J. Lopes da Silva, 1983). Also, the increase in the interest rates increased the transfer of emigrants’ remittances.

Furthermore, the program established ceilings to credit expansion of 23%, meaning that the net domestic credit of the banking credit should not expand by more than 23% of the initial money

stock during the program year. Even though this measure was not fundamental to improve the balance of payments, it certainly was desirable (J. Lopes da Silva, 1983).

Also, the IMF imposed the expansion of the sub ceilings of credit to the public sector. This allowed for an increase in the public sector borrowing from the banking system from 44 billion escudos to 56 billion. Despite improving the balance of payments, this measure had consequences on the overall budget deficit in 1978 which reached 8,4% of GDP (J. Lopes da Silva, 1983).

Lastly, the program intended to increase supplies by correcting price distortions. The program stimulated the improvement in the efficiency of investments by correcting cost-price distortions and relative profitability rates (J. Lopes da Silva, 1983).

Success of the program

To evaluate the success of the program, it is key to analyze if the objectives desired were indeed fulfilled.

The main objective of the program was to improve the balance of payments. As J. Lopes da Silva states the account deficit between March of 1978 and March of 1979 was only 520 million dollars, an outlook that was much more favorable than expected, as the objective was to reduce the deficit to 1 billion dollars, in the period mentioned. According with the data withdrawn from the Bank of Portugal, it is noticeable that the balance of payments improved significantly from 1977 to 1979. The balance of payments rose back from an 8,9% deficit (in % of GDP) in 1977 to a surplus in both 1978 (1,2% of GDP) and 1979 (6,7% of GDP) (Table 6).

Since many different measures were set by the program, it is of paramount importance to analyze which variables impacted the most in tackling the balance of payments deficit.

The external equilibrium can be given by the following equation:

Equation 1:

$$\text{BoP} = \text{Er} + \text{Ir} + \text{Bc} + \text{Pa} + \text{Rem} + \text{Tou} + \text{Ext.Inv}$$

Where Bop=Balance of payments' deficit; Er=Exchange rate; Ir= Interest rate; Bc=Banking credit; Pa=Public account's deficit; Rem= Emigrants remittances; Tou=Tourism; Ext.Inv= External Investment.

The IMF program's measures did not focus on the possible impact of the emigrant's remittances, tourism and external investment to accomplish its objectives.

The biggest contribution to attenuate the balance of payments deficit came within the restrictive monetary policy by continuingly rising the interest rates. Between 1976 and 1979 we witnessed a real devaluation of almost twenty percent (Mateus, 1998). The effective exchange rate also gave an important contribution to tackle the balance of payments deficit, as it was devalued in real terms by 9,7% in 1977, 10% in 1978 and 4% in the following year (in real terms) (source: Bank of Portugal and OCDE Economic Outlook)

The banking credit ceilings do not seem to have had a significant impact in attenuating the balance of payment's deficit. If we use private consumption as a proxy for the banking credit, it can be noticed that the private consumption kept rising every quarter from 1977Q1 to 1980Q4 (Source: Bank of Portugal). Moreover, the reduction in the public account's deficit did not play a significant role in the process. Despite the efforts of the program to reduce the deficit, it aggravated 2 percentual points between 1977 and 1978 (Mateus, 1998).

The numerous measures introduced by the program were expected to slow down the economy. However, that did not happen during the period of 1977 to 1979. In fact, the Portuguese GDP grew 6% in the considered period. This unexpected GDP growth can be attributed to the growth in tourism and emigrants' remittances. In 1977 tourism exported 238,2 million euros (in current prices) and grew to an amount of 561,8 million euros in 1979 (in current prices) (Source: Bank

of Portugal). The emigrant remittances followed a similar trend by growing from 194,8 million euros to 532,6 million euros in the same period (current prices). These variables, despite being neglected by the IMF program, were very important not only to reduce the balance of payments deficit but to prevent the economy from slowing down. The external investment did not play an important role, as it only grew from 0,27% of the GDP in 1977 to 0,29% in 1979.

Table 7: Impact of tourism and other services in the Portuguese economy (current prices, in millions of euros)

	1977	1978	1979	1980	1981	1982	1983	1984	1985
Tourism and other services	238,2	341,4	561,8	762,6	891,6	954,7	1300,8	1833,8	2366,6

Source: Bank of Portugal

Table 8: Impact of emigrant remittances in the Portuguese economy (current prices, in millions of euros)

	1977	1978	1979	1980	1981	1982	1983	1984	1985
Emigrant remittances	194,8	317,8	532,6	658,3	780,6	932,8	1048,3	1378,9	1568

Source: Bank of Portugal

The inflation also showed some positive changes. In 1977 it reached 27% and slowed down to 22,6% in 1978 and 23,5% in 1979. Although inflation continued to remain high, it decelerated in the years following the IMF program.

The program successfully improved the balance of payments and generated a growth that was higher than the trade-weighted average of OECD (The Organization for Economic Cooperation and Development) countries in 1983. As positive changes were made in Portugal's economy, it is safe to say that overall the program was a success, as the main objective was

reached and on top of that, the program overcame all expectations, as the economy continued to grow. However, Portugal asked once more, for financial aid from the IMF in 1983. As Silva Lopes (Governor of the Bank of Portugal) and Vitor Constâncio (finance minister) mention in a letter to the fund, “The pressures on Portugal's balance of payments have continued strong this past year, as internal and external disequilibrium proved considerably more intractable than had earlier been expected, complicated as they are by serious structural maladjustments in the economy”

Second IMF Program

Portugal went through a period of macroeconomic crisis. After a cycle of improvement of the balance of payments, it deteriorated after 1979. In 1983, the deficit of the current account was 11,6% of the GDP. Moreover, the public accounts deficit worsened from 5,8% in 1979 to 12,5% in 1981 and 8,5% in 1982 (Mateus, 1998).

This economic crisis was a result of both external and internal causes. The international context worsened, as numerous countries in Latin America and Africa were unable to satisfy their obligations regarding their external debts (Mateus, 1998). As such, rising concerns and doubts appeared regarding the commitment of Portugal to fulfill all its external debt obligations. However, according to Abel Mateus, the main problem that originated this crisis lay on the public deficit that reached 12,5% in 1981 and 8,5% in 1982. Moreover, the balance of payments had also deteriorated, reaching a deficit of 3.2 Billion U.S dollars in 1982.

Similar to the first IMF program, the main objective was to improve the balance of payments. As the IMF states, the objective is to reduce the current account deficit in the balance of payments to a level that does not give rise to financing difficulties in the short run and that allows for a reduction in the debt service burden over the long run. Improving the balance of payments was seen as a key condition to obtaining growth and an increase in employment. The

primary objective was to reduce the deficit of the balance of payments of 3.2 billion U.S dollars in 1982, to 2 Billion U.S dollars in 1983 and to 1,25 billion U.S dollars the following year. The program intended for a significant reduction in the combined deficit of the general government and the supply fund from 12,6% (of GDP) to 9% (of GDP) in 1983 and to 6% (of GDP) the following year. Moreover, it also intended to slow down the decrease in net foreign assets of the banking system, which should not decline by no more than 160 million U.S dollars in the second half of 1983 and should remain unchanged in 1984. Lastly, the IMF targeted the reduction in the rate of consumer price inflation from a 29 percent increase in 1983 (expected) to 20 percent in 1984.

The program also anticipated a significant decline in domestic demand in both 1983 and 1984. In fact, the fund projected that all variables of the demand were likely to decline. Private consumption was estimated to decline as a result of a decline in real disposable income of households and real wages were also expected to decline. Moreover, real GDP was also projected to decrease by 1% in 1983 and by 0,25% in 1984 as a consequence of a contraction on domestic demand, partially offset by an improvement in the real foreign balance (IMF, 1983).

The IMF was optimistic about its forecasts. If the adjustment program was rigorously followed, it “should allow the restoration of a sustainable external position and lay the foundation for a resumption of growth over the medium term” (IMF, 1983)

Table 9: Balance of payments of Portugal

	1981	1982(p)	1983(f)	1984(f)
Exports	4088	4119	4535	5000
Imports	9282	8972	8385	8340
Merchandise trade balance	-5194	-4853	-3850	-3340

Source: IMF report

(p) Provisional estimates

(f) Forecasts

The measures to secure the desired objective were set towards policies aimed at contracting domestic demand by imposing budgetary restraints and measures to strengthen the financial position of public enterprises, and at switching resources to the export sector.

The first pack of measures were set in June of 1982 by the new government in office which included a 12 percent effective devaluation of the currency, substantial increases in the prices of a wide range of subsidized commodities, the freezing of the public sector investment program pending review, the introduction of an extraordinary company profit tax and new future measures to obtain additional revenue to reduce the public budget deficit.

The fiscal policy was the most important contributor to the main objective that was set. The cash deficit of the general government was set to be reduced from 229 billion escudos (Portuguese currency at the time) in 1983 to 207 billion escudos in the following year. In order to achieve this targeted deficit, measures towards an increase in the tax burden and adjustments in administered prices would be put in practice (increase in prices of several products including petroleum products). Moreover, the government would be introducing an additional package of tax measures to increase the government's revenue. These measures included increases in the rates of selected indirect taxes (the stamp tax and various excises) and a once-over tax on

incomes for the rest of 1983. Lastly, the authorities would contain the public deficit through a tighter control of expenditure by reducing the funds towards public companies and contention of increases in salaries (IMF, 1983).

In terms of the monetary policy, measures should focus on improving the balance of payments as well as the deceleration of inflation. As such, authorities set the deceleration in the rate of growth of total domestic credit from over 29 percent in 1982 to 27,5 percent the following year and around 21,5 percent in 1984. The Portuguese authorities would pursue the targeted deceleration in the credit aggregates through both a more effective enforcement of the credit ceilings set by the Bank of Portugal and an increase in the effective cost of credit. To this end penalties for noncompliance with the ceilings will be raised to 100 percent and rates in the interbank bond market will be increased by several percentage points over the following months to provide commercial banks with a more attractive outlet for their excess liquidity and to reduce incentives to exceed the credit ceilings (IMF, 1983).

Lastly, in relation to external policies, the Portuguese authorities intend to maintain a competitive exchange rate in achieving the targeted external adjustment. The country has devalued their currency by 12 percent (effective devaluation) in June of 1983. To maintain competitive exchange rate, future depreciations of the currency would take place at a rate of 1 percent a month lower than the weighted basket or partner countries' currencies. Although the Portuguese authorities recognize some loss of competitiveness in this measure, wage settlements around 20 percent in both 1983 and 1984 are expected to happen that will prove sufficient to maintain an adequate level of competitiveness. The authorities are also committed to the maintenance of an exchange system free of restrictions on payments and transfers or current international transactions. They will refrain from introducing new restrictions on trade and from intensifying existing ones for balance of payments reasons, and will enact in the 1984

budget the rollback of the import surcharge to 10 percent from the 30 percent to which it was raised in January of 1983 (IMF, 1983).

Success of the program

The program was successful in tackling the countries' biggest economic problems. In particular, the external deficit reduced from 12% in 1982 to just 2% two years later. However, inflation rose to 34% in 1983 as a consequence of the devaluation and rising administrative prices. This particular situation was reviewed the following year and was set a limit of 23% growth of the inflation rate. (Mateus, 1998)

A similar equation will be created in order to understand which variables impacted the most in the program's objectives.

Equation 2:

$$\text{BoP} = \text{Er} + \text{Ir} + \text{Bc} + \text{Pa} + \text{Rem} + \text{Tou} + \text{Ext.Inv}$$

Where Bop=Balance of payments's deficit; Er=Exchange rate; Ir= Interest rate; Bc=Banking credit; Pa=Public account's deficit; Rem= Emigrants remittances; Tou=Tourism; Ext.Inv= External Investment.

Contrary to the first IMF program, in the second IMF program the fiscal policy towards reducing the public account's deficit made an enormous impact in solving the balance of payments deficit. In particular, the government was able to reduce the deficit from 8% in 1982 to 6% in the following year,

The exchange rate did not play a major role in the program, as in fact it grew from 79,5 in 1982 to 146,4 in 1984 (LCU's per US\$, period average) (Source: World Bank). The same happened with the monetary policy, where the interest rates increased from 1,91 in 1982 to 2,62 in 1983 and 3,80 in the following year. The banking credit ceilings did not play an important role as

well. If we take the private consumption as a proxy, it can be stated that private consumption rose significantly from 9821,8 million euros in 1982 to 12310,2 million euros in 1984 (Source: Bank of Portugal)

Tourism registered an enormous increase rising from 954,7 million euros to 1833,8 million euros between the period of 1982 and 1984 (Table 7). The emigrant remittances also continued to grow from 932,8 million euros to 1378,9 million euros (Table 8). The external investment also grew from 0,47% of GDP to 0,79% of GDP reflecting both rising external investments combined with a decreasing GDP. All these three variables contributed positively to solve the balance of payments deficit while, at the same time, played an important role in preventing the decrease of GDP. Despite that, the GDP did slow down during the second IMF program as a consequence of the program's measures that were very strict and extreme in increasing revenue through higher taxes and reducing expense through a tighter control of expenditures. Although the measures undoubtedly contribute to the reduction of the balance of payments deficit, it decreased the internal demand and, consequently, the GDP that not even increasing revenues in tourism, emigrants' remittances and external investment could balance.

Besides a decrease in GDP that reached 1,5% in 1984, unemployment rate rose to 7% in 1984 and real salaries fell 7,6% between 1982 and 1985 (Mateus, 1998).

Despite some negative consequences of the program's measures, the program overall was considered a success as the main objectives of the program were accomplished.

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